# CZAR RESOURCES LTD.

## 1991 ANNUAL REPORT

Reed April 20, 1992

# Annual Meeting

The Annual Meeting of the Shareholders of Czar Resources Ltd. will be held on Friday, May 22, 1992, at 10:00 a.m. in the Westin Hotel, 4th Avenue & 3rd Street S.W., Calgary, Alberta, Canada.

# Contents



Copies of the Company's Annual Information Form as filed with the Ontario Securities Commission are available upon written request free of charge to all shareholders of record and beneficial owners of shares. Requests should be directed to the Corporate Secretary at the head office address shown.

# Corporate Profile

Czar Resources Ltd. is an independent Canadian energy company engaged in the exploration for and development and production of natural gas reserves in Western Canada and the marketing and sale of natural gas to markets throughout North America.

Czar's natural gas marketing strategy is based on the acquisition of long-term contracts to supply gas to geographically diversified users, with secure transportation arrangements.

Czar's exploration and development strategy continues to target natural gas in the Western Canadian basin. The Company plans to steadily expand its existing reserves base in order to meet the natural gas reserves obligations of existing contracts and to explore in areas where new contracts may be obtained.

Czar's corporate objectives are to demonstrate per share growth in earnings, cash flow and asset value, and growth in natural gas reserves while enhancing the Company's financial strength by controlling its financial leverage.

# Highlights

| **Financial** *(thousands unless otherwise indicated)* | **1991** | 1990 | 1989 |
|---|---|---|---|
| Total Revenue | **$ 20,985** | $ 21,189 | $ 19,884 |
| Funds Flow from Operations | **$ 6,693** | $ 7,669 | $ 6,799 |
| Funds Flow Per Share | **$ 0.18** | $ 0.21 | $ 0.24 |
| Net Earnings (Loss) | **$ (387)** | $ 1,637 | $ 1,301 |
| Net Earnings (Loss) Per Share | **$ (0.01)** | $ 0.05 | $ 0.05 |
| Capital Expenditures | **$ 9,368** | $ 14,217 | $ 11,105 |
| Total Assets | **$ 65,375** | $ 66,110 | $ 61,300 |
| Common Shares Outstanding | **36,445** | 36,280 | 35,556 |

## Operating

| | | | |
|---|---|---|---|
| Production (Before Royalties) | | | |
| Natural gas (BCF) | **16.1** | 14.8 | 14.6 |
| Average daily production (MMCF/D) | **44.2** | 40.5 | 40.1 |
| Crude oil and natural gas liquids (MSTB) | **106** | 118 | 136 |
| Average daily production (BBLS/D) | **291** | 324 | 374 |
| Drilling Activity | | | |
| Gas completions | **9** | 16 | 15 |
| Dry and abandoned | **4** | 1 | 3 |
| Total wells | **13** | 17 | 18 |

## Land and Reserves

| | | | |
|---|---|---|---|
| Undeveloped Land Holdings (net acres) | | | |
| British Columbia | **89,762** | 127,941 | 97,490 |
| Alberta | **60,151** | 47,436 | 43,624 |
| Saskatchewan | **5,218** | 2,761 | – |
| Total acres | **155,131** | 178,138 | 141,114 |
| Reserves (proved and probable) | | | |
| Before Royalties | | | |
| Gas (BCF) | **205** | 226 | 195 |
| Oil & NGLs (MSTB) | **1,261** | 1,445 | 1,161 |
| After Royalties | | | |
| Gas (BCF) | **158** | 174 | 155 |
| Oil & NGLs (MSTB) | **936** | 1,101 | 908 |

# To The Shareholders

On behalf of the Board of Directors, I am pleased to report on 1991, a year in which the Company's efforts produced reasonable operating results despite an extremely difficult gas marketing environment.

Czar reported record natural gas sales and satisfactory financial results for 1991. The most significant accomplishment of the year was the completion of a major expansion of the compression and gas gathering facilities in the Helmet field in British Columbia, which doubled the production from Czar's largest gas field.

The decline in natural gas prices in the spring of 1991 had a negative impact on funds flow from operations and earnings for the year and the decline has been repeated in the spring of 1992. This has resulted in increasing concerns for the natural gas industry over the next year, despite steadily improving fundamentals, including increasing demand and shrinking supply.

## Corporate Strategy

Czar's corporate strategy is to build a natural gas reserves base and revenue stream with which to maximize its participation in the anticipated recovery and growth phase of the natural gas industry in Canada.

Czar's plan is based on the view that the Canadian natural gas industry will steadily improve, primarily due to the continued deterioration in the fundamentals of the natural gas industry in the United States and the resulting increasing demand for natural gas imports from Canada.

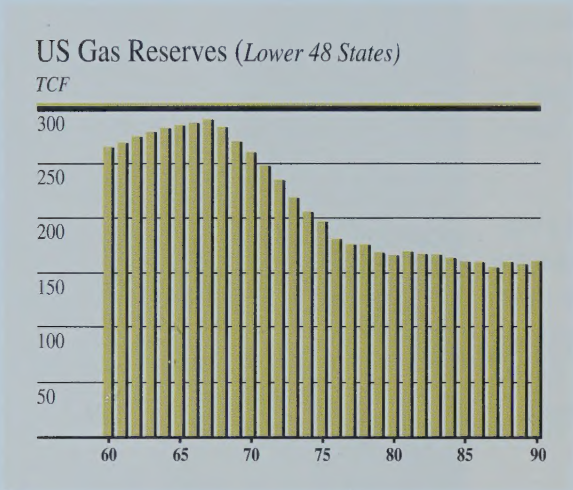
One of the keys to Czar's corporate strategy has been the acquisition of a portfolio of long-term natural gas development contracts. These contracts allow for the development of a portion of the contracted reserves over a period of years and permit the exploration, development and financing of gas production to be conducted with the assurance that the gas can be produced immediately and sold under satisfactory pricing terms and rates of production.

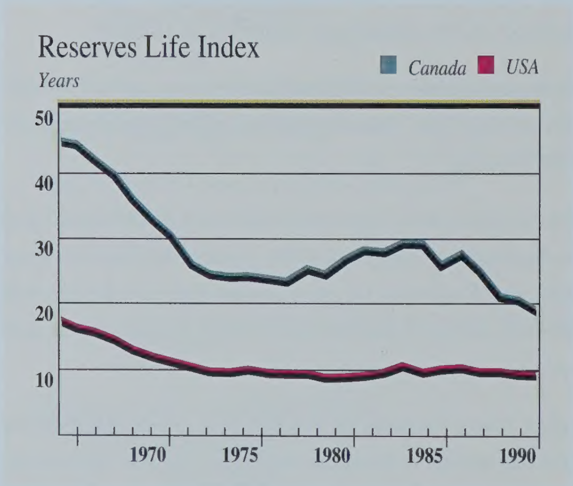
While long-term contracts have historically yielded higher prices than those available to spot marketers in Alberta, the general drop in gas prices in the United States has reduced producer netbacks and the short-term value of these contracts. In addition, the protracted efforts by regulators in California to reduce contractual takes and terminate long-term contracts with California utilities has increased the uncertainty as to the value of California export contracts.

Despite the foregoing, we believe that long-term contracts, in which buyers and sellers trade off price for supply assurance and guaranteed pipeline capacity, should clearly produce significant benefits when gas supply and demand return to an acceptable balance. Czar therefore plans to continue its efforts to maintain and expand such contracts to the limit that the Company's financial structure allows. However, due to this current gas price uncertainty, the Company has also commenced an oil exploration and exploitation program to diversify its revenue base.

## Natural Gas Outlook

Czar's business plan was developed on the premise that natural gas is a North American energy commodity in a mature phase of its development cycle, and that United States gas reserves are in an irreversible decline, a trend which will eventually result in a commodity shortage and price recovery.




This has been demonstrated by the steady decline of natural gas reserves in the lower 48 United States since 1969. As a result, the natural gas reserve life index of the United States was reduced to a level of nine years by the end of 1990. Another indicator that United States gas supply has not kept pace with growing demand is the increase of Canadian natural gas exports to the United States, which doubled from 800 billion cubic feet in 1986 to 1.6 trillion cubic feet in 1991. Over the past three years, consumption in the United States has increased by an average of 500 BCF per year. Canadian gas exports share of this increase has grown from 9% in 1989 to 20% in 1991.

In this environment, the most significant factors determining the success of Czar's long-term strategic gas marketing plan will be the interrelationship of: (i) natural gas demand; (ii) the available supply of gas; and (iii) natural gas prices.

Preliminary estimates for 1991 show that despite the recession and continued above average temperatures throughout North America during the winter heating season, United States gas demand rose to 19.7 trillion cubic feet, the highest level since the early 1980's. At the same time, the greatly improved transportation and gas storage system in the United States and increased Canadian exports, have resulted in the lowest commodity price since the late 1970's.

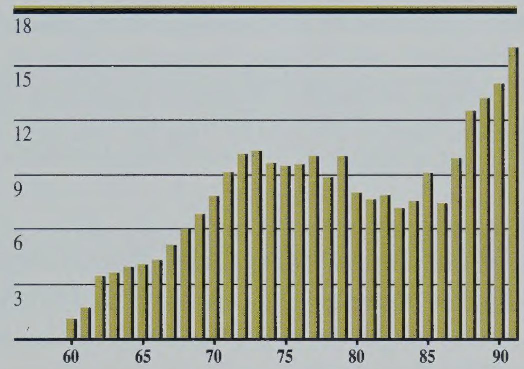
The effect of short-term commodity prices on revenues of natural gas producers clearly outweigh the increasing demand and long-term price implications. As a result, the number of gas wells completed, the number of drilling rigs currently exploring for natural gas, the number of seismic crews working and other measures of industry activity have declined to near historic lows.

The logical outcome of these factors is a decline in the United States natural gas productive capacity and, when coupled with either an increasing demand caused by an economic recovery in the United States or a return to normal winter heating demand, this should lead to higher gas prices. In addition, continuing pressure for cleaner, more environmentally acceptable fuels, primarily in the area of electric power generation, should give rise to greater long-term demand for natural gas throughout the balance of the 1990's.

Hence, prospects appear excellent for Canadian natural gas producers with long-term gas reserves and contracts. The Western Canadian basin has been more sparsely drilled than the more mature United States basins, and opportunities for finding and developing large new pools of natural gas still exist. The opportunities to acquire low cost gas reserves either through exploration or acquisition are excellent and will play a significant role in Czar's plans to increase reserves and export more natural gas to the United States at steadily improving prices.

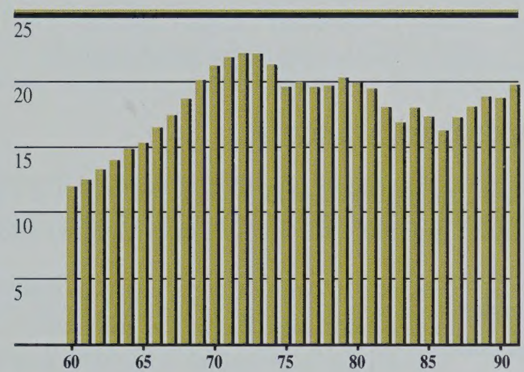
Canadian Gas Exports

*TCF*




US Natural Gas Consumption

*TCF*



## Gas Marketing Highlights

The Company's ongoing gas acquisition and development strategy has been to focus on reserves and deliverability requirements of natural gas development contracts yielding the highest and most secure prices. Consequently, the Company focused its efforts on the expansion of production facilities in the Helmet area of northeastern British Columbia to prepare for significantly higher production levels under the Alberta & Southern Gas Co. Ltd. and BC Gas Inc. contracts, both of which allowed for increased deliverabilities from November 1, 1991.

An expansion of the Helmet compression and gas gathering system was completed in March, 1991 and increased deliverabilities from the Helmet area from 20 million cubic feet per day to 60 million cubic feet per day. This enabled the Company to increase sales to 30 million cubic feet per day to Alberta & Southern and 20 million cubic feet per day to BC Gas, which resulted in record production volumes and revenues for November and December of 1991.

During the summer of 1991, large volumes of gas from the newly completed Helmet facilities were sold in the spot market at low prices until increased sales under the long-term contracts commenced.

In Alberta, the Company focused its efforts on increasing deliverability to contracts with KannGaz Producers Ltd., ProGas Limited and Unigas Corporation and in 1991, Czar increased net production by 2.2 MMCF/D as a result of gas developed for these contracts.

## Operating Mandate

While Czar has operated throughout the 1980's in a conservative fashion due to financial constraints, the impact of lower gas prices has resulted in even closer attention to the following principal operating mandates:

- Financial Control: Czar attempts to match its capital expenditures to cash flow from operations and equity financing. The only significant exception to this policy resulted from the development of the Helmet gas field and the construction of the gas gathering and compression system, to supply natural gas reserves and deliverability for the Alberta & Southern contract.

- Operating Focus: Czar concentrates its activities in specific geographic areas of the Western Canadian sedimentary basin, operates virtually all of its projects and participates for working interests as large as its joint venture arrangements and financial guidelines permit.

- Joint Ventures: the Company operates under a joint management and resource development structure with two associated companies. This provides Czar with lower overhead costs, the economic synergy of a larger financial base, and larger natural gas reserves which permit access to more gas marketing opportunities.

## Financial

Increased gas sales through the new Helmet facilities offset poorer than anticipated gas prices throughout the summer of 1991 and resulted in satisfactory financial results for the year.

Revenues of $21 million for 1991 were unchanged from 1990, while funds flow from operations of $6.7 million, or $0.18 per share, for the period was lower than the $7.7 million, or $0.21 per share in 1990, due to higher operating and interest expenses. The Company's additions to fixed assets of $9.4 million were substantially lower than the $14.2 million reported in 1990.

The Company's reinvestment plans for 1992 provide for capital expenditures to be considerably less than funds from operations, allowing excess funds to be used to reduce debt.

## Outlook

By the end of 1991, Czar was producing record volumes of natural gas and had honoured the requirements of the contracts in its gas marketing portfolio.

The overall economic outlook for North America, especially as it pertains to the strength and timing of a recovery, is uncertain. Similarly, many aspects of the Company's principal business, including gas pricing through the summer months of 1992, the impact of proposed federal pipeline deregulation in the United States, and the unresolved contractual problems pertaining to California, dictate a cautious approach to any expansion plans or investments in natural gas.

This dilemma is somewhat frustrating as the commodity outlook for gas, assuming the turning point is imminent, appears to be particularly bright. In fact, a long-term upward trend for natural gas demand and prices appears virtually certain for the balance of the decade.

Czar's management challenge is to take the initiative to develop and use a wide variety of new financing and operating strategies to continue to hold and expand its natural gas contract portfolio while minimizing gas pricing risks. With the Company's previous record of expansion in difficult financial and business climates, I am confident of a similar successful outcome from the management and staff's efforts during 1992.

On behalf of the Board

R.W. Lamond
Chairman of the Board
April 10, 1992

## The Natural Gas Industry

Czar maintains its long-held view that the Canadian natural gas industry will steadily improve through the 1990's, primarily due to the continued deterioration of gas fundamentals in the United States and the resulting increasing demand for natural gas imports from Canada.

Natural gas demand in the United States increased to an estimated 19.7 trillion cubic feet in 1991 despite the negative effect of the North American recession and a string of abnormally warm winter heating seasons. The inability of American producers to meet this demand is reflected in Canadian imports growing to a record level of approximately 1.6 TCF in 1991. More importantly, Canada's share of the increasing United States demand is also growing, improving the prospects of the Canadian industry. Demand for natural gas in the United States will continue to grow with the combined effect of an economic recovery, a return to normal winter heating demand and increasing environmental pressure to use cleaner burning environmentally friendly fuels. However, despite the obvious trend for increasing demand, the effects of current low prices on producers' revenues are inhibiting an increase in supply. Lower prices have reduced the availability of capital for the industry and substantially reduced drilling activity. In January of 1992, the number of active drilling rigs in the United States was 650, with 290 drilling for natural gas. This is the lowest level of activity in over 40 years.

The combined effect of these supply and demand trends moving in opposite directions will be an eventual shortage of natural gas and resultant price increase. However, since the timing and extent of the improvement in the Canadian natural gas industry is difficult to predict, Czar's business plan is aimed at maintaining its natural gas reserve base, maximizing production and prices and, in the immediate future, increasing its emphasis on oil production.

## Business Plan

The effectiveness of Czar's contract driven strategy is demonstrated by six years of steady growth in natural gas production and until 1991, Czar's average gas price rose steadily compared to industry prices remaining flat or declining.

Strategic steps Czar has taken to implement its Business Plan include the following:

- Czar operates joint ventures with two associated energy companies. This provides Czar with the economic synergy of a larger financial base and a critical mass of natural gas reserves increasing gas marketing opportunities.
- Participating for as large a percentage as possible in new projects, thereby minimizing overhead and maximizing the benefits of the Company's gas marketing efforts.
- Exploring in select gas prone areas where sizeable reserves can be developed and the Company can build and control production facilities.
- Actively pursuing the acquisition of shut-in reserves where Czar contracts provide negotiating leverage and value added opportunies.

However, weaker than anticipated gas prices in the spring and summer of 1991 and the spring of 1992, resulted in a reappraisal of the Company's business plan for the short-term. Czar's plan has been modified during this period of gas price uncertainty by reducing its planned capital expenditure program and the percentage of funds allocated to adding natural gas reserves and by commencing an oil exploration and exploitation program to increase the Company's oil reserves and production and diversify its revenue base.

Czar Average Wellhead Gas Price

*$/MCF*

## Natural Gas Marketing

### Corporate Objectives

The objectives of the Czar Group's natural gas marketing efforts are to:

- maintain dedicated reserves and deliveries to long-term contracts;
- search for new market opportunities with potential for high rates of take, attractive netback pricing, long-term export outlets and opportunities to expand reserves and deliverability.
- monitor the political and regulatory activities which may impact on the value of current and future gas contracts, and modify the business plan accordingly.

The Czar Group's portfolio of long-term contracts aggregates in excess of 600 BCF of gross dedicated reserves and is comprised of the following key contracts:

| Buyer | Gross Dedicated Reserves (BCF) | Gross Daily Contract Quantity, DCQ (MMCF/D) | **Czar 1991 Net Production (MMCF/D)** | **%** |
|---|---|---|---|---|
| Alberta & Southern Gas Co. Ltd. | 220 | 40.0 [1] | **5.1** | **11.5** |
| KannGaz Producers Ltd. | 55 | 10.5 | **6.8** | **15.3** |
| Unigas Corporation[2] | 40 | 10.8 | **1.6** | **3.6** |
| ProGas Limited | 30 | 6.1 | **1.9** | **4.3** |
| Sherritt Fertilizer Company | 50 | 16.0 | **3.4** | **7.7** |
| BC Gas Inc.[3] | 40 | 30.0 | **1.9** | **4.3** |
| Other, Long-Term | 195 | 30.0 | **6.1** | **13.8** |
| Other, Short-Term | – | – | **17.4** | **39.5** |
| Totals | 630 | 143.4 | **44.2** | **100.0** |

[1] The Alberta & Southern DCQ increases from 30 MMCF/D to 40 MMCF/D on November 1, 1992.
[2] Full contract volumes will commence by November 1, 1992.
[3] Contract deliveries commenced November 1, 1991.

The majority of the Company's efforts in 1991 were directed at increasing deliverability to meet the requirements of the contracts. Major efforts were also required in continued surveillance and involvement in numerous hearings regarding significant regulatory activities in the natural gas industry.

## California Markets

One such matter is the regulatory interference in the State of California where the California Public Utilities Commission (CPUC) and its advisory body, the Division of Ratepayer Advocates (DRA), have directed their efforts to restructuring the gas purchasing policies of the California utility, Pacific Gas and Electric Company (PG&E). This will have a significant impact on Czar's natural gas sales contract with Alberta & Southern. In a cooperative effort with the CPUC, Alberta & Southern's producers, including Czar, negotiated the Access Agreement which provided for the following transition:

- 25% of Alberta & Southern's contract volume would be available on a direct sale basis from August 1, 1991 to October 31, 1994, and would be supplied from the Alberta & Southern pool.
- From November 1, 1994, the 25% direct sale volume could be supplied from other Canadian sources.

However, after the Access Agreement went into effect, the CPUC reneged on its position and ruled that it had not endorsed the Access Agreement, that open access on the pipeline would occur by November 1, 1992 and that the long-term contract with Alberta & Southern was not binding, thus allowing California gas users access to low-priced, Canadian spot gas.

Fortunately, joint action has been taken by the federal National Energy Board (NEB) and Alberta Energy to ensure that the long-term contracts must be honoured before short-term gas is available. This action has served to stabilize the situation. The Company is optimistic that a satisfactory outcome to this situation can be concluded, which includes a transition period and satisfactory compensation for any contractual loss.

Czar is in a fortunate position in that its contracted reserves have a strategic geographic advantage of being located in British Columbia. Alberta & Southern entered into a substantial long-term contract providing for the resale of contracted gas to BC Gas Inc. Irrespective of the eventual resolution of the California dispute, Czar expects its gas will continue to flow at contract rates.

## Other U.S. Markets

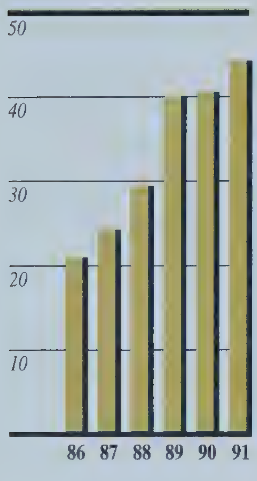
In another development, the United States Federal Energy Regulatory Commission (FERC) has issued a proposed notice to open up access on the U.S. pipeline systems, referred to as the MEGA Notice of Proposed Rulemaking, or MEGA NOPR, which if implemented in its current form could have a significant negative impact on gas prices and gas contract load factors. Although the outcome cannot be accurately predicted, the Company is guardedly optimistic that its long-term contracts will remain competitive in a period of firming U.S. demand and gas prices. In addition, the Company believes that its firm transportation on the Canadian pipeline systems will be recognized as an additional benefit to its long-term secure supplies of natural gas, by knowledgeable U.S. buyers.

## Growth Opportunities

The Czar Group has the opportunity to contract and tie-in an additional 275 BCF of natural gas with deliverability of up to 50 million cubic feet per day over the next three years. The Company's plan to take advantage of this opportunity includes the exploration for, development and acquisition of proven reserves and contract sharing, whereby the Company earns an interest in reserves by supplying contracts for shut-in gas.

Gas Production

*MMCF/Day*




## Production

Czar's natural gas production continued to increase through 1991 and reached a record volume of 51.4 MMCF/D in December of 1991. Production averaged 44.2 MMCF/D in 1991 compared with 40.5 MMCF/D in 1990.

In the first quarter of 1991, Czar completed a major expansion of the Helmet compression and gas gathering system which increased the deliverability from the area from 20 MMCF/D to 60 MMCF/D. This expansion was required to increase sales to Alberta & Southern and BC Gas, to 30 MMCF/D and 20 MMCF/D respectfully, from November 1, 1991. As a result, Czar's net gas production in British Columbia increased to an average of 27.4 MMCF/D in 1991 from 21.1 MMCF/D in 1990. Czar's B.C. gas is presently sold under long-term contracts to Alberta & Southern, BC Gas and CanWest. In Alberta the reduced level of activity resulted in gas sales declining to average 16.7 MMCF/D in 1991 from 19.4 MMCF/D in 1990. The Company's Alberta gas is sold primarily under long-term contracts with KannGaz, Unigas, ProGas and Sherritt.

In November of 1991 Czar tied-in nine additional wells in the Gadsby and Drumheller areas to replace declines in production from reserves dedicated to the KannGaz and Unigas contracts. As a result Czar's Alberta production increased to an average 20.6 MMCF/D in December of 1991.

## Exploration and Development

In 1992, Czar participated in drilling fewer wells than in prior years due to a focus of its capital expenditures on constructing production facilities, land and seismic acquisitions. The Company participated in 13 wells, resulting in eight gas wells, one potential gas well and four dry holes.

**Drilling Results**

| | Gas Wells | | Oil Wells | | Dry Holes | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Gross | Net | Gross | Net | Gross | Net | Gross | Net |
| **1991** | **9** | **5.5** | **0** | **0** | **4** | **1.4** | **13** | **6.9** |
| 1990 | 16 | 8.0 | 0 | 0 | 1 | 0.3 | 17 | 8.3 |
| 1989 | 15 | 9.3 | 0 | 0 | 3 | 2.0 | 18 | 11.3 |
| 1988 | 15 | 9.1 | 0 | 0 | 4 | 2.7 | 19 | 11.8 |
| 1987 | 22 | 9.0 | 1 | 0.9 | 9 | 3.9 | 32 | 13.8 |
| 1986 | 15 | 8.6 | 2 | 0.1 | 2 | 1.0 | 19 | 9.7 |
| | 92 | 49.5 | 3 | 1.0 | 23 | 11.3 | 118 | 61.8 |

During 1991, Czar conducted development drilling operations in three areas in Alberta. Two wells were drilled in the Drumheller area and another two were drilled in the Gadsby area and placed on production through existing company owned pipeline and plant facilities. Three wells were drilled in the Wimborne area to maintain land and provide reserves dedicated to the ProGas contract.

Exploration activity focused on continuation of the exploration activity in the Helmet area of British Columbia, and drilling and geophysical activity on a shallow gas horizon in the area straddling the Alberta and Saskatchewan border. In Helmet, the Company followed the very successful 1990 drilling season with two exploratory wells in an effort to further expand the natural gas pool to the north. Unfortunately both wells were unsuccessful, however they provided additional information regarding the more complex stratigraphy of this large gas prone horizon. Czar plans to continue to be active in this area during next year. The level of activity will depend upon the resolution of the California marketing problem and the demand for gas from the area.

The Company continued exploration activities in eastern Alberta and western Saskatchewan on the geophysically delineated shallow gas prospect. Additional lands were purchased on this prospect and several new drilling targets have been identified on these properties through interpretation of acquired seismic. Five wells were drilled on locations defined by these geophysical leads over 1991 and 1992 resulting in four gas wells and one dry hole. These prospects require a considerable reliance on seismic interpretation and although the results were more varied than anticipated, the interpretation is becoming more reliable and the most recent well tested gas at rates of up to 1.3 MMCF/D from two zones and has given the Company more assurance of the future exploration potential of the prospect. Czar plans to expand its activities in the area and anticipates production to commence early in 1993. Czar has selected this area for future exploration focus because of the low risk, low drilling and completion costs and high potential deliverability of these wells.

As a result of the change in Czar's business plan subsequent to year end, the Company drilled and completed an excellent Charlie Lake oil well in northeast British Columbia. This well, in which Czar has a 55% working interest, is currently producing at an allowable of 63 BBLS/D. A direct offset well is planned for the second quarter of 1992.

## Reserves

The following is a summary of a report prepared by Fekete Associates on the resource properties of the Company as at December 31, 1991.

**Reserves**

| | Before Royalties | | After Royalties | |
|---|---|---|---|---|
| | Natural Gas (BCF) | Oil & NGLs (MSTB) | Natural Gas (BCF) | Oil & NGLs (MSTB) |
| Proved Developed | 156.3 | 1221.9 | 119.3 | 906.6 |
| Proved Undeveloped | 32.2 | 1.8 | 25.6 | 1.2 |
| Total Proved | 188.5 | 1223.7 | 144.9 | 907.8 |
| Probable | 16.3 | 37.7 | 12.6 | 28.5 |
| Total Proved and Probable | 204.8 | 1261.4 | 157.5 | 936.3 |

**Estimated Present Value of Future Net Revenues ($ Millions)**

| | Undiscounted | 10% | 15% | 20% |
|---|---|---|---|---|
| Proved Developed | $217.8 | $ 91.4 | $ 71.2 | $ 58.5 |
| Proved Undeveloped | 29.1 | 9.4 | 5.7 | 3.5 |
| Total Proved | 246.9 | 100.8 | 76.9 | 62.0 |
| Probable | 29.5 | 4.7 | 2.3 | 1.2 |
| Total Proved and Probable | $276.4 | $105.5 | $ 79.2 | $ 63.2 |

Czar's reserves consist primarily of natural gas and therefore the estimated reserves and the estimated future net revenues are impacted most directly by changes in the estimated future price of natural gas. In the 1991 reserve report the consultant assumed a natural gas price of $1.31/MCF in 1992, escalating to $2.06/MCF over the next five years. The 1990 report assumed a price of $1.57/MCF in 1992, escalating to $2.33 over the next five years. The change in price forecast is a 22% reduction from the previous report. This assumption has two effects on the results of the report. Firstly, the estimated quantity of economically recoverable reserves decreased because wells become uneconomic at this price level or reach the end of their economic lives sooner. Secondly, the estimated future net revenues are lower and the net present value of the future cash flows is therefore reduced. As a result the consultant's estimate of the net present value of future net revenues of Czar's reserves, using a 15% discount rate, was reduced to $79 million at December 31, 1991, a decline of 29% from December 31, 1990.

Proven reserves of natural gas declined by 10% to 188.5 BCF. Oil and gas liquids declined by 15% to 1.2 million barrels. Proven producing reserves declined by only 5% despite 16.1 BCF of production during the year.

## Reserves Continuity

| Natural Gas (BCF) | | Proved | Probable | Total |
|---|---|---|---|---|
| Reserves at December 31, 1989 | | 167.8 | 27.1 | 194.9 |
| Production 1990 | | (14.8) | – | (14.8) |
| Additions 1990 | – Exploration | 34.2 | – | 34.2 |
| | – Net Acquisitions | 6.2 | – | 6.2 |
| Revisions | | 16.5 | (10.9) | 5.6 |
| Reserves at December 31, 1990 | | 209.9 | 16.2 | 226.1 |
| Production 1991 | | (16.1) | – | (16.1) |
| Additions 1991 | – Exploration | 2.6 | 0.1 | 2.7 |
| | – Net Acquisitions | 0.5 | – | 0.5 |
| Revisions | | (8.4) | – | (8.4) |
| Reserves at December 31, 1991 | | 188.5 | 16.3 | 204.8 |
| **Natural Gas Liquids (MSTB)** | | | | |
| Reserves at December 31, 1989 | | 691.4 | 30.1 | 721.5 |
| Production 1990 | | (55.8) | – | (55.8) |
| Additions 1990 | – Exploration | 129.4 | – | 129.4 |
| | – Net Acquisitions | – | – | – |
| Revisions | | 119.3 | 33.1 | 152.4 |
| Reserves at December 31, 1990 | | 884.3 | 63.2 | 947.5 |
| Production 1991 | | (50.5) | – | (50.5) |
| Additions 1991 | – Exploration | – | – | – |
| | – Net Acquisitions | – | – | – |
| Revisions | | (76.7) | (25.5) | (102.2) |
| Reserves at December 31, 1991 | | 757.1 | 37.7 | 794.8 |
| **Oil (MSTB)** | | | | |
| Reserves at December 31, 1989 | | 351.2 | 87.9 | 439.1 |
| Production 1990 | | (62.4) | – | (62.4) |
| Additions 1990 | – Exploration | – | – | – |
| | – Net Acquisitions | – | – | – |
| Revisions | | 209.1 | (87.9) | 121.2 |
| Reserves at December 31, 1990 | | 497.9 | – | 497.9 |
| Production 1991 | | (55.3) | – | (55.3) |
| Additions 1991 | – Exploration | – | – | – |
| | – Net Acquisitions | – | – | – |
| Revisions | | 24.0 | – | 24.0 |
| Reserves at December 31, 1991 | | 466.6 | – | 466.6 |

Czar's limited 1991 exploration and reserve acquisition program added 3.1 BCF or only 20% of 1991 production of 16.1 BCF. This was a reflection of the Company's reduced exploration drilling program as land and production facility expansion were the primary focus of the capital expenditures. The Company had 188.5 BCF of proven natural gas at December 31, 1991, which at the current production level of 16.1 BCF per year is an 11.7 year reserve life index. Czar's oil and natural gas liquid reserves have a 15 and 8.4 year reserve life index respectively.

**Summary of Natural Gas Production and Reserves by Province**

| | **1991** | | 1990 | | 1989 | |
|---|---|---|---|---|---|---|
| | **BCF** | **%** | BCF | % | BCF | % |
| **Alberta** | | | | | | |
| Proved Developed | **57.07** | **28%** | 69.15 | 31% | 73.73 | 38% |
| Proved Undeveloped | **1.19** | **1%** | 2.20 | 1% | 1.99 | 1% |
| Total Proved | **58.26** | **29%** | 71.35 | 32% | 75.72 | 39% |
| Probable | **4.72** | **2%** | 6.57 | 3% | 12.87 | 7% |
| Total Alberta | **62.98** | **31%** | 77.92 | 35% | 88.59 | 46% |
| **British Columbia** | | | | | | |
| Proved Developed | **99.26** | **48%** | 95.76 | 42% | 88.15 | 45% |
| Proved Undeveloped | **30.95** | **15%** | 42.77 | 19% | 3.84 | 2% |
| Total Proved | **130.21** | **63%** | 138.53 | 61% | 91.99 | 47% |
| Probable | **11.61** | **6%** | 9.65 | 4% | 14.20 | 7% |
| Total British Columbia | **141.82** | **69%** | 148.18 | 65% | 106.19 | 54% |
| Total | **204.80** | **100%** | 226.10 | 100% | 194.78 | 100% |
| **Production** | | | | | | |
| Alberta | **6.10** | **38%** | 7.08 | 48% | 7.50 | 51% |
| British Columbia | **10.03** | **62%** | 7.70 | 52% | 7.10 | 49% |
| | **16.13** | **100%** | 14.78 | 100% | 14.60 | 100% |

# Financial

**Management's Discussion and Analysis Of Financial Condition and Results of Operations**

Czar's financial results for 1991 were poorer than anticipated but satisfactory in view of the natural gas price decline experienced during the year.

Revenue reported in 1991 was $21 million, unchanged from the prior year. Increases in operating and interest expenses resulted in funds flow from operations declining to $6.7 million or $0.18 per share from $7.7 million or $0.21 per share in 1990. Depletion and depreciation charges of $7 million for the year resulted in Czar reporting a loss of $387,000 or $0.01 per share, compared with earnings of $1.6 million or $0.05 per share in 1990.

### Revenue

Czar is primarily a natural gas exploration and production company with natural gas revenues representing over 90% of the Company's production revenue. The Company's producing properties are located in Alberta and British Columbia, with approximately 62% of the Company's production coming from British Columbia.

### British Columbia Production

Czar's primary focus over the past three years has been to develop natural gas reserves in British Columbia. As a direct result of this effort, natural gas production increased to average 27.4 MMCF/D in 1991 from 21.4 MMCF/D in 1990. Early in 1992 Czar tied-in 5 MMCF/D of new production in the Helmet area to provide for additional requirements of the long-term British Columbia gas contracts.

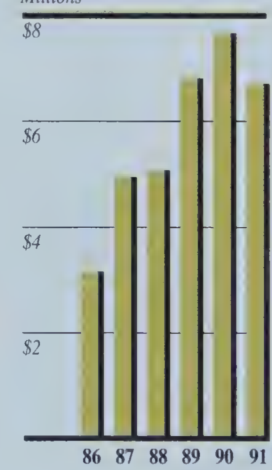
Substantially all of the Company's British Columbia reserves are dedicated to long-term contracts. Short-term gas sales from British Columbia are only made to optimize the use of long-term firm pipeline capacity. Czar currently has long-term contracts which allow for the addition of up to 95 BCF of reserves and 16 MMCF/D of deliverability in British Columbia during 1992, providing for growth opportunities in the future.

### Alberta Production

During 1991, Czar's Alberta production declined to average 16.7 MMCF/D compared with an average of 19.7 MMCF/D in 1990. This decline was due to a combination of normal reservoir declines and reduced contract demand. In November of 1991 the Company added production facilities at Gadsby and Drumheller which increased Czar's share of gas production in Alberta to 20.6 MMCF/D in December. Over 80% of Czar's 1991 gas sales in Alberta were sold under long-term contracts. Czar's Alberta long-term contracts allow for gross additions of 40 BCF of reserves and 10 MMCF/D of deliverability in 1992.

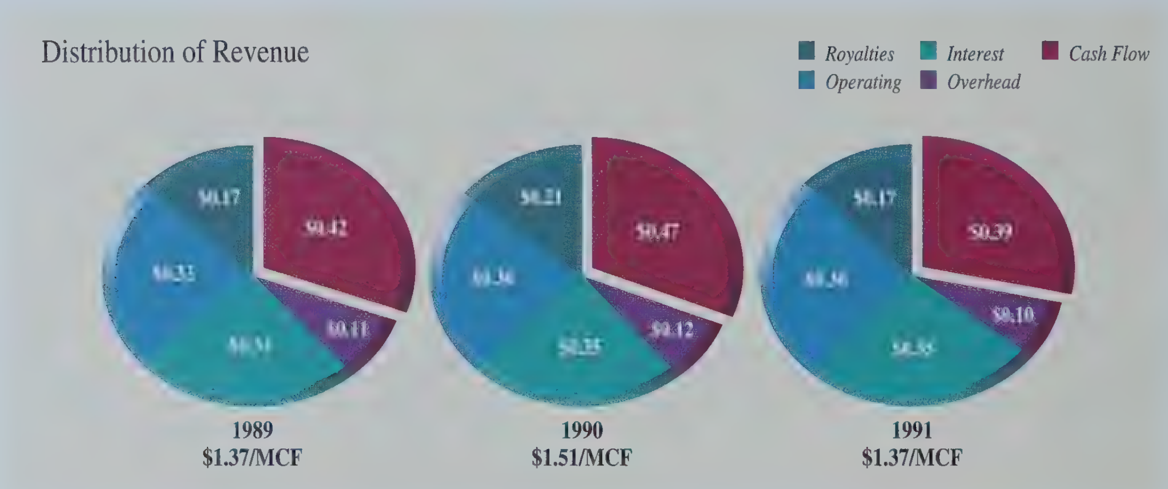
Total Revenue
*Millions*


Funds Flow from Operations
*Millions*



## Product Prices

The 9% increase in gas sales was more than offset by the effect of the decline in the average natural gas price from $1.42 per MCF in 1990 to $1.31 per MCF in 1991. In 1991, 61% of Czar's natural gas sales were sold under long-term contracts. The decline of natural gas prices reflects the impact of deregulation, a warmer than normal winter heating season, and the economic down turn in North America, combined with increasing competition for spot gas sales among the industry's producers. Although the Company was affected by the decline in price for spot sales, the fact that approximately 80% of future sales will be sold under long-term contracts will reduce the impact of future declines in spot prices. The Company has reduced the amount of gas sold to spot markets in 1991 to 39% of sales down from 51% two years earlier. Czar currently estimates that 20% of the Company's gas will be sold under spot contracts in 1992, providing satisfactory prices are obtained.




*(1) based on revenue per equivalent unit, 1 barrel = 10 MCF*

## Expenses

Operating expenses increased marginally in 1991 to $6.3 million, as a result of increased production. The cost per equivalent MCF of gas produced remained unchanged at $0.36 per MCF. General and administrative cost incurred during 1991 was $2.8 million of which $850,000 was capitalized and $1.9 million was expensed. This was modestly lower than $2.9 million incurred in 1990, $1.0 million of which was capitalized.

The major capital expenditure on the Helmet facilities, incurred early in 1991, was financed with an increase in long-term debt and this resulted in a modest increase in interest expense for 1991. Although interest rates came down during the year, Czar did not receive the full benefit of this decline as $30 million of its debt carries a fixed interest rate. Czar's effective interest rate was also higher due to a partially hedged United States dollar denominated loan program. The Company expects 1992 interest expense to be lower due to, the expiry of a 12.6% interest rate fix on $20 million, lower floating interest rates and the discontinuance of the United States loan program.

## Capital Expenditures

Czar's capital expenditure program was reduced to \$9.4 million in 1991 from \$14.2 million in 1990. The capital expenditures in 1991 and 1990 were primarily on production facilities and land acquisitions. Approximately 36% of the Company's capital expenditures in each of the past two years was incurred on production facilities. In 1991, 20% of the capital expenditures were incurred on land and reserve acquisitions, compared with 23% in 1990.

## Income Taxes

Czar has not recorded any provision for current or deferred income taxes in 1991. Income tax deductions available to Czar exceed the book value of its assets by approximately \$48 million. The value of these tax deductions has not been recognized in the financial statements and therefore Czar will not be required to record a current or deferred income tax provision for the foreseeable future.

## Liquidity and Capital Resources

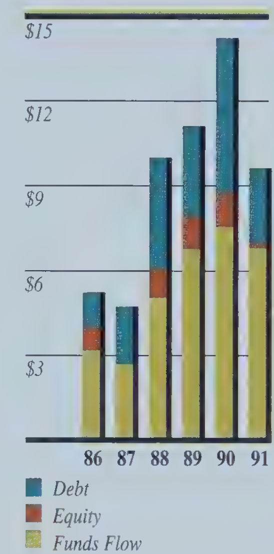
Czar's debt structure includes a \$37.5 million demand credit facility, a \$10 million debenture due in 1995 and capital lease financing of \$2.6 million to be repaid over the next four year period.

The Company's available credit facility with its banker is reviewed annually to establish a "lending base," being the value of its natural gas and oil reserves as determined by its banker. The credit facility based on the lending base established in 1991 was \$37.5 million, and is anticipated to reduce to \$35.5 million in 1992. At December 31, 1991, the Company had utilized \$31.6 million of its credit facility.

The Company is able to use its undrawn credit facility line together with its funds flow from operations in its oil and gas operations as it deems advisable. Czar plans to use less than its 1992 funds flow from operations in its capital expenditure program and use the balance to reduce its debt during the year.

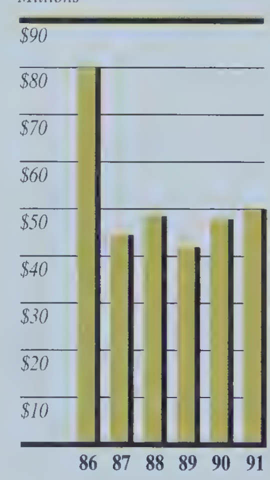
Financing of Capital Expenditures

*Millions*

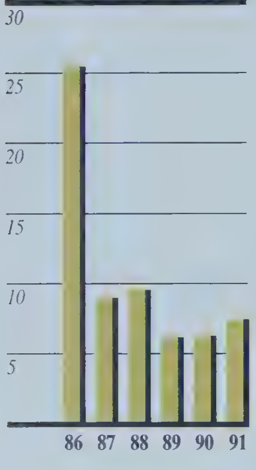



Total Net Liabilities

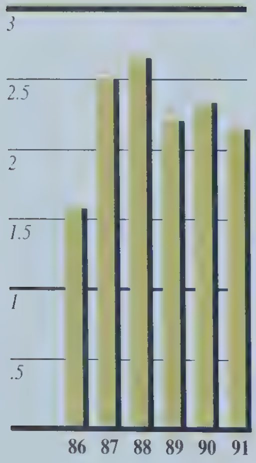
*Millions*



Total Debt/
Annual Funds Flow
*Multiple*




Fixed Charge
Coverage
*Cash Flow Coverage*




**Sensitivity Analysis**

Czar's revenues, funds flow from operations and earnings are dependent upon the changes in the economic environment within which it operates. As part of its normal operations, Czar endeavors to control variables which can be controlled at a reasonable economic cost. However, some variables are not controllable at a cost which would be economically viable. The following table demonstrates the potential effect of changes in key variables on Czar's funds flow from operations, both in total and on a per share basis. The information is based on Czar's forecast of production volumes and prices for 1992.

| Key Variable | Change in Variable | Impact on Annual Funds Flow $000 | $/Share[1] |
|---|---|---|---|
| Natural gas | | | |
| Production MMCF/D | 1.0 | $ 402 | $ 0.011 |
| Price $/MCF | $ 0.10 | $ 1,610 | $ 0.044 |
| Interest rate | 1% | $ 320 | $ 0.009 |

[1] Per share calculations are based on outstanding shares at December 31, 1991

# Auditors' Report

We have audited the consolidated balance sheets of Czar Resources Ltd. as at December 31, 1991 and 1990 and the consolidated statements of earnings and retained earnings and source and use of cash for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1991 and 1990 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Calgary, Alberta
March 6, 1992

Peat Marwick Thorne
Chartered Accountants

# Consolidated Balance Sheet

*As at December 31*

| *(in thousands of dollars)* | **1991** | 1990 |
|---|---|---|
| **Assets** | | |
| Current Assets | | |
| Accounts receivable | **$ 5,474** | $ 8,928 |
| Inventory of supplies | **223** | 214 |
| | **5,697** | 9,142 |
| Property, Plant and Equipment (note 2) | **59,303** | 56,486 |
| Deferred Financing Costs | **375** | 482 |
| | **$ 65,375** | $ 66,110 |
| **Liabilities** | | |
| Current Liabilities | | |
| Accounts payable and accrued liabilities | **$ 11,452** | $ 11,412 |
| Current portion of long-term debt | **989** | 894 |
| | **12,441** | 12,306 |
| Long-Term Debt (note 3) | **33,244** | 34,250 |
| Convertible Debentures (note 4) | **9,998** | 9,998 |
| Site Restoration Provision | **704** | 312 |
| **Shareholders' Equity** | | |
| Capital Stock (note 5) | **7,738** | 7,607 |
| Retained Earnings | **1,250** | 1,637 |
| | **8,988** | 9,244 |
| | **$ 65,375** | $ 66,110 |

Approved by the Board:

, Director

, Director

# Consolidated Statements of Earnings and Retained Earnings

*Years ended December 31*

| *(in thousands of dollars except per share amounts)* | **1991** | 1990 |
|---|---|---|
| Revenue | | |
| Production | **$ 26,398** | $ 25,973 |
| Transportation costs | **(3,234)** | (2,382) |
| Royalties | **(3,982)** | (4,500) |
| Alberta royalty tax credit | **958** | 1,155 |
| Net Production Revenue | **20,140** | 20,246 |
| Processing revenue | **703** | 535 |
| Other | **142** | 408 |
| | **20,985** | 21,189 |
| Expenses | | |
| Production | **6,300** | 5,906 |
| General and administrative | **1,938** | 1,929 |
| Interest on long-term debt | **6,054** | 5,685 |
| Depletion and depreciation | **7,080** | 6,032 |
| | **21,372** | 19,552 |
| Net Earnings (Loss) | **(387)** | 1,637 |
| Retained Earnings (Deficit) at Beginning of Year | **1,637** | (52,905) |
| Authorized reduction of share capital applied to deficit (note 5) | **–** | 52,905 |
| Retained Earnings at End of Year | **$ 1,250** | $ 1,637 |
| Net Earnings (Loss) per Common Share | **$ (0.01)** | $ 0.05 |

# Consolidated Statements of Source and Use of Cash

*Years ended December 31*

| *(in thousands of dollars except per share amounts)* | **1991** | 1990 |
|---|---|---|
| Cash provided by (used for): | | |
| Operating Activities | | |
| Net earnings (loss) | **$ (387)** | $ 1,637 |
| Depletion and depreciation | **7,080** | 6,032 |
| Funds flow from operations | **6,693** | 7,669 |
| Change in non-cash working capital related to operations | **3,455** | (1,267) |
| | **10,148** | 6,402 |
| Financing Activities | | |
| Bank credit facility | **(522)** | (1,900) |
| Conversion of debenture to shares | **–** | (2) |
| Issuance of common shares | **131** | 852 |
| Capital lease obligations | **(389)** | 1,126 |
| | **(780)** | 76 |
| Investing Activities | | |
| Property, plant and equipment expenditures | **(9,368)** | (14,217) |
| Increase (Decrease) in Cash | **–** | (7,739) |
| Cash at Beginning of Year | **–** | 7,739 |
| Cash at End of Year | **$ –** | $ – |
| Funds Flow from Operations per Common Share | **$ 0.18** | $ 0.21 |

# Notes to the Consolidated Financial Statements

*(Tabular amounts in thousands of dollars unless otherwise indicated)*

## 1. Accounting Policies

(a) The consolidated financial statements include the accounts of Czar Resources Ltd. and its subsidiary company, which is wholly-owned.

(b) Petroleum and Natural Gas Operations

(i) The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized by cost centre. A separate cost centre is established for each country in which the Company operates. The Company presently only operates in Canada. Costs include land acquisition costs, geological and geophysical expenditures, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, related overhead expenditures and capitalized interest related to major development projects. The costs in each cost centre, together with estimated future site restoration and abandonment costs, are depleted using the composite unit of production method based upon estimated proved reserves after royalties. Crude oil reserves are converted to equivalent units of natural gas based on the relative energy content of each product.

During 1990, the Company commenced providing for estimated future site restoration and abandonment costs as part of the depletion provision. The provision for these costs is recorded as a long-term liability.

(ii) Full Cost Ceiling Test
The net book value in each cost centre which can be carried forward for amortization against revenues of future periods is limited to an amount equal to the estimated future net revenues from proved reserves, based on current prices and costs, plus the lower of cost or estimated fair value of unproved properties. The aggregate net book value of all cost centres less deferred income taxes and the provision for abandonment costs is limited to the estimated future net revenues from proved reserves plus the lower of cost or estimated fair value of unproved properties less estimated future general and administrative expenses, financing costs, income taxes and future site restoration and abandonment costs.

(iii) Included in production revenue and expenses is consideration received for the sale of properties by the Company to certain drilling partnerships. Principal and interest payments are received based on a percentage of net revenue from the wells drilled by the partnerships. Unpaid principal installments total $36,150,000 at December 31, 1991 (1990 – $36,970,000). Principal and interest payments, which are recorded as and when received, are included in revenue and expenses as follows:

| | **1991** | 1990 |
|---|---|---|
| Production revenue | **$ 1,704** | $ 2,020 |
| Royalties | **(218)** | (274) |
| Production expenses | **(648)** | (576) |
| | **$ 838** | $ 1,170 |

(iv) All of the Company's exploration and development activities related to petroleum and natural gas are conducted with others; the Company records only its proportionate interest in such activities.

## 4. Convertible Debentures

The unsecured convertible debentures bear interest at 8.75% per annum payable semi-annually on June 15 and December 15 and mature on June 15, 1995.

The debentures are convertible into common shares of the Company at the option of the holder at any time prior to June 16, 1995 at a conversion price of $1.70 per common share. The conversion price is subject to adjustment in certain events.

Prior to December 31, 1993, the debentures are redeemable if the common shares of the Company have traded at least at 125% of the conversion price for 20 consecutive trading days. Thereafter, they are redeemable at any time. The debentures are redeemable at par plus accrued interest and at an amount equal to 103% of par if redeemed prior to July 1, 1992, which reduces by 1% on each of July 1, 1993, 1994 and 1995.

## 5. Capital Stock

(a) Authorized Capital Stock

10,000,000 First preference shares issuable in series
10,000,000 Second preference shares issuable in series
Unlimited number of common shares

(b) Issued Common Shares

| | Number of Shares | Amount |
|---|---|---|
| Balance December 31, 1989 | 35,555,615 | $ 59,660 |
| Authorized reduction of share capital | – | (52,905) |
| On conversion of debenture | 1,176 | 2 |
| Flow-through share arrangements, net of incentives renounced | 614,270 | 717 |
| Employee savings plan | 105,256 | 123 |
| For cash on exercise of option | 3,300 | 3 |
| 1989 issue cost adjustment | – | 7 |
| Balance December 31, 1990 | 36,279,617 | 7,607 |
| Employee savings plan | 165,511 | 131 |
| Balance December 31, 1991 | 36,445,128 | $ 7,738 |

At the annual and special meeting of shareholders held on June 7, 1990, the shareholders approved a reduction of share capital of $52,905,000, being the Company's consolidated deficit at December 31, 1989.

(c) Common Share Options

Directors, officers and employees hold options to purchase 2,424,000 common shares of the Company at an exercise price of $1.02 from time to time to September 22, 1994, and 37,500 common shares at an exercise price of $1.12 from time to time until July 16, 1995.

(d) Common Share Purchase Warrants

The Company has outstanding common share purchase warrants which entitle the holders to purchase common shares as follows:

| Number of Shares | Price | Expiry Date |
|---|---|---|
| 232,571 | $ 2.09 | September 23, 1992 |
| 2,700,000 | $ 1.50 | December 31, 1992 |

(e) Employee Savings Plan

The employee savings plan provides for employee savings of up to 5% of salary which is matched by the Company in the form of common shares of the Company and Orbit Oil & Gas Ltd. in the same ratio as the reimbursement ratio for the immediately preceding year as defined in the joint venture agreement (note 9). During the year ended December 31, 1991, employees became entitled to receive 165,511 common shares (1990 – 105,256)

## 6. Income Taxes

At December 31, 1991, the Company had approximately $107,000,000 of tax deductions available to reduce future years' income for tax purposes. The benefit of the excess of the amount over the net book value of the related assets has not been reflected in the financial statements.

The following table reconciles the expected tax provision based on current combined federal and provincial rates (44%) to the actual tax provision.

| | **1991** | 1990 |
|---|---|---|
| Expected income tax provision (recovery) | **$ (170)** | $ 720 |
| Increase (decrease) in expected tax provision: | | |
| Non taxable gain on sale of subsidiary | **(42)** | (37) |
| Non-deductible provincial royalties and lease rentals | **1,276** | 1,393 |
| Other non-deductible items | **32** | 36 |
| Non-deductible depletion | **220** | 197 |
| Alberta royalty tax credit | **(421)** | (508) |
| Resource allowance | **(1,196)** | (1,368) |
| Earned depletion allowance | **–** | (41) |
| Utilization of prior years' losses | **–** | (392) |
| Unrecognized benefit of losses | **301** | – |
| Actual income tax provision | **$ –** | $ – |

## 7. Segmented Information

The Company has a single line of business which is the exploration for and the development and production of petroleum and natural gas in Canada. The Company's production revenue includes $4,365,000 ($3,810,000 U.S.) of export sales to the United States (1990 – $3,671,000: $3,146,000 U.S.)

## 8. Gain on Sale of Subsidiary Companies

In 1986, the Company received two promissory notes aggregating $2.1 million U.S. as consideration for the sale of shares of certain subsidiaries. As payment of the notes is dependent on certain future events, gains are recorded as payment on the notes is received. To December 31, 1991, the Company has received $1.3 million U.S. in respect of these notes.

## 9. Related Party Transactions

In 1991, Canadian Frobisher Resources Ltd., the major shareholder of which is a director and officer of the Company, participated with the Company in its exploration and development operation pursuant to a joint venture agreement entered into on January 6, 1989.

Pursuant to the agreement, Frobisher participated in essentially all of the drilling and acquisition activities of the Company. Frobisher earns 17% of the Company's interest in properties by paying 20% of the Company's share of the costs of drilling and completion operations and 17% of acquisition costs. During the year ended December 31, 1991, Frobisher incurred costs of $1,287,000 (1990 – $2,615,000) pursuant to the agreement and at December 31, 1991 there was a payable of $133,000 to Frobisher. At December 31, 1990 there was a receivable of $164,000 from Frobisher.

Effective May 1, 1989, the Company entered into a joint venture and management agreement with Orbit Oil & Gas Ltd., a corporation with certain common directors, officers and shareholders, whereby the Company and Orbit share overhead costs and jointly participate in new exploration, development and acquisition activities. The Company is reimbursed for a proportionate share of its costs and expenses incurred in providing overhead services based upon the relative revenue and capital expenditures of the two companies. All oil and gas activities conducted on properties acquired subsequent to May 1, 1989, are conducted with Orbit in a sharing ratio established annually. At December 31, 1991, there was a receivable from Orbit of $475,000 (1990 – $1,542,000).

# Corporate Information

### Board of Directors

R.W. Lamond [1,2]
Chairman of the Board
President and CEO
of the Corporation
Calgary, Alberta

Frank Benevento II
President and CEO
Energy Recovery
Management Inc.
Chevy Chase, Maryland

Brian C. Bentz [1,2]
Vice President, Finance
H.A Simons (Overseas) Ltd.,
Vancouver, B.C.

Donald M. Deacon
Independent Businessman
Charlottetown, P.E.I.

Ashley G. Down [2]
Merchant Banker
Advisor to Prudential-Bache
Capital Funding
London, England

Ed Mattheis [1,2]
President
Melaar Resources Ltd.
Calgary, Alberta

Charles A. Teare
Executive Vice President
and CFO of the Corporation
Calgary, Alberta

Allan R. Twa
Partner
Burnet, Duckworth & Palmer
Calgary, Alberta

[1] Audit Committee
[2] Compensation Committee

### Officers and Senior Personnel

Robert W. Lamond
Chairman, President
and CEO

Charles A. Teare
Executive Vice President
and CFO

P. Richard Ewacha
Vice President, Production

Allan R. Twa
Corporate Secretary

Paul M. Boechler
Controller

Wayne T. Radcliffe
District Land Manager

Sharon P. Runge
District Land Manager

Herbert J. Visscher
Exploration Manager

Donald K. Clark
Production Manager,
British Columbia

Philip W. Payzant
Production Manager,
Alberta

Kumar Mendis
Accounting Manager

Russ M. Sych
Senior Production Foreman
Alberta Production Operations

Warren M. Smith
Senior Production Foreman
British Columbia Production
Operations

### Corporate Office

2100, 144 - 4 Avenue S.W.
Calgary, Alberta
T2P 3N4
Tel: (403) 265-0270
Fax: (403) 263-2341

### Legal Counsel

Burnet, Duckworth & Palmer
Calgary, Alberta

### Auditors

Peat Marwick Thorne
Calgary, Alberta

### Registrar & Transfer Agent

Montreal Trust of Canada
Calgary, Alberta

### Stock Listings

The Toronto Stock Exchange
Trading Symbol CZR

### Reserve Engineering Consultants

Fekete Associates Inc.
Calgary, Alberta

***Abbreviations***

*Throughout this report, standard oil and gas abbreviations have been used. Their explanation is as follows:*

| | |
|---|---|
| *BBLS* | *Barrels* |
| *MSTB* | *Thousand Stock Tank Barrels* |
| *MMCF/D* | *Million Cubic Feet Per Day* |
| *BBLS/D* | *Barrels Per Day* |
| *MCF* | *Thousand Cubic Feet* |
| *MMCF* | *Million Cubic Feet* |
| *BCF* | *Billion Cubic Feet* |
| *TCF* | *Trillion Cubic Feet* |
| *NGLs* | *Natural Gas Liquids* |

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*Printed in Canada by Phoenix Press Inc.*

## Consolidated Statements of Earnings and Retained Earnings

*Six Months Ended June 30, 1991*
*(Unaudited)*

| *(in thousands of dollars except per share amounts)* | **1991** | 1990 |
|---|---|---|
| Revenue | | |
| Production | **$13,424** | $13,143 |
| Transportation costs | **(1,602)** | (1,123) |
| Royalties | **(2,145)** | (2,445) |
| Alberta royalty tax credit | **546** | 668 |
| Net production revenue | **10,223** | 10,243 |
| Processing revenue | **365** | 244 |
| Other | **15** | 212 |
| | **10,603** | 10,699 |
| Expenses | | |
| Production | **3,086** | 2,928 |
| General and administrative | **1,002** | 1,172 |
| Interest on long-term debt | **2,865** | 2,507 |
| | **6,953** | 6,607 |
| Cash Flow From Operations | **3,650** | 4,092 |
| Depletion and depreciation | **(3,336)** | (2,678) |
| Gain on sale of subsidiary companies | **–** | 83 |
| Net Earnings | **314** | 1,497 |
| Retained Earnings (Deficit) at Beginning of Period | **1,637** | (52,905) |
| Authorized reduction of share capital applied to deficit | **–** | 52,905 |
| Retained Earnings at End of Period | **$ 1,951** | $ 1,497 |
| Per Common Share | | |
| Net earnings | **$ 0.01** | $ 0.04 |
| Cash flow – Basic | **$ 0.10** | $ 0.11 |

## Consolidated Statements of Source and Use of Cash

*Six Months Ended June 30, 1991*
*(Unaudited)*

| *(In thousands of dollars)* | **1991** | 1990 |
|---|---|---|
| Cash provided by (used for): | | |
| Operating Activities | | |
| Cash flow from operations | **$ 3,650** | $ 4,092 |
| Change in non-cash working capital related to operations | **(94)** | (4,100) |
| | **3,556** | (8) |
| Financing Activities | | |
| Bank loan | **2,789** | (1,327) |
| Issuance of common shares | **64** | 789 |
| Capital lease obligations | **(347)** | (231) |
| | **2,506** | (769) |
| Investing Activities | | |
| Property, plant and equipment expenditures pursuant to: | | |
| Flow-through share arrangements | **(125)** | (656) |
| Current operations | **(5,853)** | (6,033) |
| Proceeds from sale of subsidiary company | **–** | 83 |
| | **(5,978)** | (6,606) |
| Increase (decrease) in Cash | **84** | (7,383) |
| Cash at Beginning of Period | **–** | 7,739 |
| Cash at End of Period | **$ 84** | $ 356 |

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Printed in Canada



# CZAR RESOURCES LTD.

2

**Interim Report**
for the six months
ending June 30, 1991

Reco Sept 10
1991

# TO THE SHAREHOLDERS

I am pleased to report the results of the Company's operations for the first half of 1991. During this period the Company set new records in gas production volumes and reported satisfactory financial results despite both lower natural gas prices and the extremely unsettled North American natural gas climate. While the Company anticipates similar results for the third quarter of 1991, the switch of a high proportion of its natural gas sales from spot to long-term contract sales in the final quarter should enable the Company to close out this unsettled year on a satisfactory footing.

## Highlights

| *(000's except per share information)* | **1991** | 1990 |
|---|---|---|
| Total revenue | **$10,603** | $10,699 |
| Cash flow from operations | **$ 3,650** | $ 4,092 |
| Cash flow per share | **$ 0.10** | $ 0.11 |
| Net earnings | **$ 314** | $ 1,497 |
| Earnings per share | **$ 0.01** | $ 0.04 |
| Capital expenditures | **$ 5,978** | $ 6,689 |
| Average common shares outstanding | **36,296** | 36,041 |

## Financial

Revenue for the first half of 1991 remained constant at $10.7 million. Cash flow for the period was $3.7 million or $0.10 per share compared with $4.1 million or $0.11 per share in 1990 and earnings for the period were $0.4 million or $0.01 per share compared with $1.5 million or $0.04 per share in 1990.

Increased natural gas production was offset by lower gas prices for the period.

Capital expenditures for the second quarter were limited to $1.6 million compared with the $4.4 million incurred in the first quarter, bringing capital expenditures for the first six months in 1991 to $6 million, closer in line with the Company's cash flow for the period. Czar will continue to reduce its capital expenditures for the balance of the year in order to balance expenditures with cash flow.

## Production

With the completion of the Helmet gas gathering system expansion, Czar increased its natural gas production to record levels averaging 45.5 MMCF/D for the second quarter of 1991.

The increased deliverability from the Helmet area was developed for long-term contract requirements commencing in November, 1991. In the interim the majority of the increased sales were delivered under short term contracts, which were subject to a rapid decline in price during the second quarter of 1991. As a result production revenue during the quarter did not match increased production volumes.

### Production Summary

| | *Six Months Ended June 30* | | |
|---|---|---|---|
| | **1991** | 1990 | 1989 |
| Natural Gas (MMCF/D) | **43.9** | 41.0 | 39.7 |
| Oil and NGLs (BBLS/D) | **316** | 345 | 403 |

### Product Price

| | *Six Months Ended June 30* | | |
|---|---|---|---|
| | **1991** | 1990 | 1989 |
| Natural Gas ($/MCF) | **$ 1.37** | $ 1.56 | $ 1.34 |
| Oil and NGLs ($/BBL) | **$18.63** | $18.09 | $16.34 |

## Exploration and Development

The largest capital expenditures during the quarter were the acquisition of interests in two separate natural gas production facilities, in the Bashaw and the Chigwell areas of Southern Alberta. The Company has wells currently producing through the Bashaw plant and the purchase will reduce operating expenses associated with those wells. The Chigwell 4-32 well was tied in to the new facility and placed on stream in June at a rate of 1.5 MMCF/D.

Drilling activity in the second quarter was limited to one gas well in the Drumheller area of Alberta.

Czar also continued to acquire prospective acreage and seismic in Alberta and Saskatchewan during the second quarter of 1991.

### Drilling Results

| | *Six Months Ended June 30* | | |
|---|---|---|---|
| | **1991** | 1990 | 1989 |
| Gas wells | **5** | 10 | 10 |
| Dry holes | **4** | 1 | 1 |
| Total | **9** | 11 | 11 |

## Outlook

While Czar is very concerned with the weak and unsettled nature of the natural gas market, at present the Company's portfolio of contracts should enable a high level of sales with satisfactory pricing to resume after November 1, 1991.

Looking at the longer term, the impact of lower United States gas prices through 1991 has given rise to significant forces in the natural gas supply and demand equation. On the demand side, it is noteworthy that increases in natural gas use, especially in the industrial demand sector, have continued even during this period of recession. The high level of demand bodes well for even higher takes when the recession ends, and should also allow for a period of higher gas prices before inter-fuel switching recommences.

On the supply side, the current low gas prices are having an immediate negative impact on exploration activity in the United States. Consequently, drilling rig activity, offshore activity and other industry barometers are rapidly dropping and should give rise to a reduced level of gas replacement in the United States for this year.

In reviewing the foregoing factors, a reasonable case can be made that with either a modest level of economic recovery or a normal winter heating season, natural gas prices will recover in the medium term to the previously prevailing levels, resulting in a significant increase in profitability for companies with leverage to natural gas.

On behalf of the Board of Directors

R.W. Lamond
Chairman of the Board
August 22, 1991

# Consolidated Statements of Earnings and Retained Earnings

*Six Months Ended June 30, 1992*
*(Unaudited)*

| *(in thousands of dollars except per share amounts)* | **1992** | 1991 |
|---|---|---|
| Revenue | | |
| Production | **$13,783** | $13,424 |
| Transportation costs | **(1,334)** | (1,602) |
| Royalties | **(2,202)** | (2,145) |
| Alberta royalty tax credit | **528** | 546 |
| Net production revenue | **10,775** | 10,223 |
| Processing and other | **450** | 380 |
| | **11,225** | 10,603 |
| Expenses | | |
| Production | **2,873** | 3,086 |
| General and administrative | **1,106** | 1,002 |
| Interest on long-term debt | **2,203** | 2,865 |
| Depletion and depreciation | **3,646** | 3,336 |
| | **9,828** | 10,289 |
| Net Earnings | **1,397** | 314 |
| Retained Earnings at Beginning of Period | **1,250** | 1,637 |
| Retained Earnings at End of Period | **$ 2,647** | $ 1,951 |
| Net Earnings Per Common Share | **$ 0.04** | $ 0.01 |

# Consolidated Statements of Source and Use of Cash

*Six Months Ended June 30, 1992*
*(Unaudited)*

| *(in thousands of dollars except per share amounts)* | **1992** | 1991 |
|---|---|---|
| Cash Provided By (Used For): | | |
| Operating Activities | | |
| Net earnings | **$ 1,397** | $ 314 |
| Depletion and depreciation | **3,646** | 3,336 |
| Funds flow from operations | **5,043** | 3,650 |
| Change in non-cash working capital related to operations | **(2,808)** | (94) |
| | **2,235** | 3,556 |
| Financing Activities | | |
| Long-term bank debt | **90** | 2,789 |
| Issuance of common shares | **72** | 64 |
| Capital lease obligations | **(548)** | (347) |
| | **(386)** | 2,506 |
| Investing Activities | | |
| Property, plant and equipment expenditures | **(1,849)** | (5,978) |
| Increase in Cash | **–** | 84 |
| Cash at Beginning of Period | **–** | – |
| Cash at End of Period | **$ –** | $ 84 |
| Funds Flow Per Common Share | **$ 0.14** | $ 0.10 |

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# CZAR RESOURCES LTD.

# 2

SECOND INTERIM REPORT
FOR THE SIX MONTHS
ENDING JUNE 30, 1992

# To The Shareholders

Rcvd Sept 8, 1992

I am pleased to report very positive financial and operating results for the six months ended June 30, 1992. Czar recorded record levels of revenue, funds from operations and improved earnings as a result of higher natural gas prices and significantly lower interest costs.

### Highlights

| (000's except per share information) | 1992 | Six Months Ended June 30 1991 | 1990 |
|---|---|---|---|
| Total revenue | **$11,225** | $10,603 | $10,699 |
| Funds flow from operations | **$ 5,043** | $ 3,650 | $ 4,092 |
| Funds flow per share | **$ 0.14** | $ 0.10 | $ 0.11 |
| Net earnings | **$ 1,397** | $ 314 | $ 1,497 |
| Earnings per share | **$ 0.04** | $ 0.01 | $ 0.04 |
| Capital expenditures | **$ 1,849** | $ 5,978 | $ 6,689 |
| Average common shares outstanding | **36,484** | 36,296 | 36,041 |

## Financial

Czar's revenues for the first half of 1992 were $11.2 million compared with $10.6 million for the same period in 1991. Higher revenues and lower expenses resulted in funds from operations for the period totalling $5 million, or $0.14 per share compared with $3.7 million, or $0.10 per share for the first half of 1991. Earnings for the period also increased, to $1.3 million, or $0.04 per share, compared with $0.3 million, or $0.01 per share in 1991.

During the first half of 1992 Czar maintained a conservative investment policy and reinvested $1.8 million, or 37% of funds generated from operations. During the period, Czar reduced its debt by $3.2 million.

The 12.6% fixed interest rate on $20 million of Czar's debt expired on April 27, 1992 and Czar began to benefit from the effect of declining interest rates. Interest costs during the first six months of 1992 were reduced by over $600,000.

## Production

### Product Prices

| | 1992 | Six Months Ended June 30 1991 | 1990 |
|---|---|---|---|
| Natural Gas ($/MCF) | **$ 1.40** | $ 1.37 | $ 1.56 |
| Oil and NGLs ($/BBL) | **$17.27** | $18.63 | $18.09 |

The demand for Canadian natural gas exports continued to be strong throughout the first half of 1992 and United States gas prices increased significantly. As a result of higher U.S. demand, the rates of take for Czar's export contracts have remained high throughout the period. Consequently Czar's average gas price during the second quarter of 1992 increased to $1.38/MCF from $1.22/MCF during the second quarter of 1991. The average price received by Czar during the first half of 1992 was $1.40/MCF compared with $1.37/MCF in 1991. I am encouraged by the fact that the market for U.S. gas is strong and shows every indication of remaining strong throughout the balance of 1992.

Oil and NGL prices have remained relatively unchanged during the first half of 1992, averaging $17.27/BBL for the period. This compares with $18.63/BBL received during the first half of 1991.

### Production Summary

| | 1992 | Six Months Ended June 30 1991 | 1990 |
|---|---|---|---|
| Natural Gas (MMCF/D) | **44.0** | 43.7 | 41.0 |
| Oil and NGLs (BBLS/D) | **355** | 316 | 345 |

Czar's natural gas production for the period averaged 44.0 MMCF/D compared with 43.7 MMCF/D in 1991. Natural gas production from British Columbia accounted for 53% of the total gas produced during the period.

Oil production from a recently completed well at Owl in Northeastern British Columbia, resulted in Czar's total production of liquids increasing to 355 BBLS/D, compared with 316 BBLS/D for the same period in 1991.

## Exploration and Development Activity

### Drilling Results

| | 1992 | Six Months Ended June 30 1991 | 1990 |
|---|---|---|---|
| Gas wells | **2** | 5 | 10 |
| Oil wells | **1** | 0 | 0 |
| Dry holes | **0** | 4 | 1 |
| Total | **3** | 9 | 11 |

Czar did not participate in the drilling of any wells during the second quarter.

During 1992 Czar's corporate strategy is to focus the company's efforts on increasing natural gas reserves and production through property acquisitions to maximize the benefit of access to U.S. natural gas markets through long-term export contracts.

During the first half of 1992, Czar completed three natural gas property acquisitions in Alberta. One of the properties included a producing well and wells on the other two properties are anticipated to be connected and producing by November 1992.

In August 1992 Czar and its Joint Venture partners entered into an agreement to purchase additional natural gas reserves in the July Lake pool in the Helmet field in Northeastern British Columbia. The acquisition will be effective December 31, 1992 and will result in an expansion of the Helmet compression and gathering facilities, the connection of two additional wells, and will increase the deliverability of the July Lake pool by 18 MMCF/D. Czar's net cost to acquire an additional 4.1 BCF of natural gas reserves and expand the system will be offset by a credit received for Czar's share of the equalization of the existing gas gathering facilities.

A production sharing agreement with a new partner in the pool will allow Czar to manage the exploitation of the pool in the most efficient manner.

Czar will continue to review other opportunities to expand its asset base through property acquisitions.

## Outlook

Czar's view that the natural gas industry is commencing a cycle of steady recovery has been reinforced by increasing U.S. natural gas demand and a rebound in natural gas prices during the first half of 1992. During the last six months, U.S. gas prices have steadily increased due to a variety of factors including: the need to restore gas storage volumes to seasonal levels; increased industrial demand; high air conditioning loads; growing electrical generation requirements; more responsive gas marketing by major producers; and the introduction of natural gas pro-rationing in several states. In addition, low 1991 reserve replacement rates and the very low level of U.S. gas exploration activity bodes well for an improved supply and demand balance. From a longer term perspective, it appears that a base has been established from which a steady recovery can be predicted.

While Czar is committed to a conservative reinvestment program until economic conditions improve, we are confident that this improvement is at hand and that 1992 will prove to be a record year for Czar's operating and financial results. Czar's strategic portfolio of U.S. gas export contracts and its infrastructure of production facilities should enable the company to take full advantage of the pending upturn in the natural gas industry.

On behalf of the Board of Directors

R.W. Lamond
Chairman of the Board
August 20, 1992